

an economic review by the Federal Reserve Bank of Chicago



Business Conditions

**Motor vehicles
lead the upsurge**

Banking developments

**may
1973**

Contents

Motor vehicles lead the upsurge 3

Phenomenal sales of cars and trucks thus far in 1973 have exceeded the most optimistic forecasts offered at the turn of the year. Despite rising costs, pollution, and traffic congestion, the utility, flexibility, and prestige offered by motor transport can be expected to provide expanding markets for cars and trucks in the years ahead.

Banking developments 13

Subscriptions to *Business Conditions* are available to the public free of charge. For information concerning bulk mailings, address inquiries to Research Department, Federal Reserve Bank of Chicago, P. O. Box 834, Chicago, Illinois 60690.

Articles may be reprinted provided source is credited. Please provide the bank's Research Department with a copy of any material in which an article is reprinted.

Motor vehicles lead the upsurge

Phenomenal sales of cars and trucks thus far in 1973 have exceeded the most optimistic forecasts offered at the turn of the year. Sales would have been even higher were it not for capacity limitations on production. The motor vehicle market appears likely to retain strong momentum for months to come—perhaps through the remainder of the year.

The surge in auto sales has been accompanied by sharp increases in industry profits, and large gains in employment. As a result, automotive centers in Michigan and other Midwest states are enjoying renewed prosperity after several years of high unemployment and depressed conditions.

Impressive sales gains

The 10.9 million cars (including about 1.6 million imports) and 2.5 million trucks sold in the United States in 1972 shattered previous records. Last December, official company sales forecasts for 1973 ranged from 11 to 11.5 million cars and 2.6 to 2.8 million trucks, and were deemed optimistic by some. In the January-April period, however, car sales were at an annual rate of well over 12 million, and truck sales were at a rate of more than 3 million. Sales of both cars and trucks would have been higher if capacity to produce components and assemble vehicles were larger.

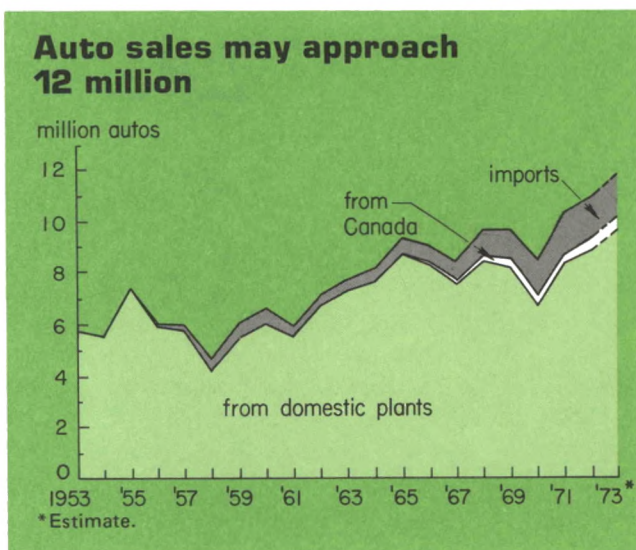
There was no sign in the spring that the motor vehicle boom was petering out. Inventories of new cars on May 1 amounted to only 49 days sales, at the daily average for April, compared to an average of 60 days supply on that date in the four

previous years. Inventories of late-model used cars also were very low and prices were strong. (An accumulation of dealer inventories of trade-ins would suggest a near-term slowdown in new car sales.) Inventories of trucks, overall, are even lower relative to sales than inventories of cars, and there are long waiting lists for various truck models, especially heavy-duty types.

Analysis of current market factors suggests to some experts that motor vehicle sales can be maintained near the rate of the first four months throughout the year. If so, vehicle sales could total 15 million, up 11 percent from last year's record, and double the total of the early 1960s. Unless the recent spectacular pace slackens substantially, motor vehicle sales are almost certain to hit a new high for the third year in a row—and by a substantial margin.

Output at capacity

In 1972, U. S. plants produced 8.8



million cars and 2.5 million trucks. The increase from 1971 was 3 percent for cars and 19 percent for trucks. Last year's truck output was a record, but last year's car output was exceeded in 1968 and was far below the 9.3 million peak reached in 1965. Output of cars and trucks combined, at 11.3 million, did exceed slightly the 1965 high of 11.1 million.

U. S. auto output was 2.7 million in the first quarter of 1973, and truck output was 810,000—both records for any quarter by a wide margin. The increase from the year-earlier period was 20 percent for cars and 28 percent for trucks. First-quarter vehicle output is expected to be about equaled in the second quarter.

Recent levels of motor vehicle output have been achieved by increasing employment about 8 percent from the level of last year, and by scheduling heavy overtime. In addition, output per man-hour appears to have increased substantially in the past year, as it has almost continuously since 1967. In the spring, many plants were operating six days a week. Producers of cars and trucks have exhorted suppliers to step up deliveries of raw materials and components. A number of idle plants have been reactivated, and expansion and modernization programs have been accelerated. Pressures to maximize motor vehicle output in the past six months have not been duplicated since the mid-1950s, except for periods preceding or following major strikes.

Production schedules for the final months of the 1973 model year were raised in the spring. Assemblies of 1973 model cars may approach 10 million, over 1 million more than the record totals for the 1965 and 1968 model years. Production is expected to continue at a high level through July, with very rapid changeovers to 1974 models in August—within a few days rather than the usual two or three weeks. For the calendar year, U. S. car output may significantly exceed the record set in 1965, which has not been seriously chal-

lenged heretofore. There were no imports of "domestic-type" cars from Canada in 1965, and production was boosted that year because of the strike losses of late 1964. Truck output should reach a new high by a wide margin in 1973 for the third year in a row.

Imports remain strong

In 1972, 20 percent of the cars sold in the United States were manufactured in other countries, about the same proportion as in each of the two previous years. From 1970 through 1972, imports from Western Europe and Japan accounted for about 15 percent of U. S. car sales, while net imports of domestic-type models from Canada accounted for about 5 percent.

Prior to 1956, more than 99 percent of the new cars sold in the United States were made here. In the following years, sales of European imports, mainly small cars, increased very rapidly, and in 1959 they accounted for 10 percent of the U. S. market. This proportion dropped back to 5 percent in the early 1960s, partly because some imports proved unsatisfactory for the U. S. market, and partly because of the introduction of smaller American-made cars. With Japanese imports growing in favor in the mid-1960s, the proportion of U. S. car sales accounted for by imports started to rise again.

Prior to 1966, almost no cars were shipped between the United States and Canada. Each of the U. S. producers had established assembly and parts plants in Canada to serve markets there without having to pay import duties. Under the Canadian-American Auto Trade Pact negotiated in 1965, tariffs were eliminated on manufacturers' shipments of cars and parts between the two nations, and U. S. producers agreed to increase manufacturing activities in Canada. Since 1965, a substantial number of cars have been shipped both ways across the border, but shipments to

the United States have heavily outnumbered shipments to Canada.

From a slow start in 1966, net shipments of cars from Canada increased steadily and reached 460,000 in 1972. Since 1970, however, imports from Canada appear to have stabilized as a proportion of U. S. sales at about 5 percent.

American and Canadian plants are producing a number of "compact" and "subcompact" autos that share the small car market with imports. Measured by weight, compacts are about three-fourths as large as standard-sized cars, while subcompacts are only half as large. In the first four months of 1973, dealer sales of domestic-type small cars were at an annual rate of 2.4 million, about 30 percent above sales of all imports, including some luxury types. Sales of the two leading domestic subcompacts, Pinto and Vega (first sold in 1971), now rival Volkswagen and are well ahead of the Toyota and Datsun, the second- and third-ranked imports.

Successive devaluations of the dollar, and rising production costs abroad, have boosted delivered prices of most foreign cars to levels equal to, or higher than, prices of comparable domestic products. Japanese and German auto producers have stated that the recent devaluation of the dollar relative to their currencies has forced them to raise prices substantially and sharply reduce their U. S. sales estimates for 1973. If they are correct, sales of imports will decline from first-quarter rates.

Market shares

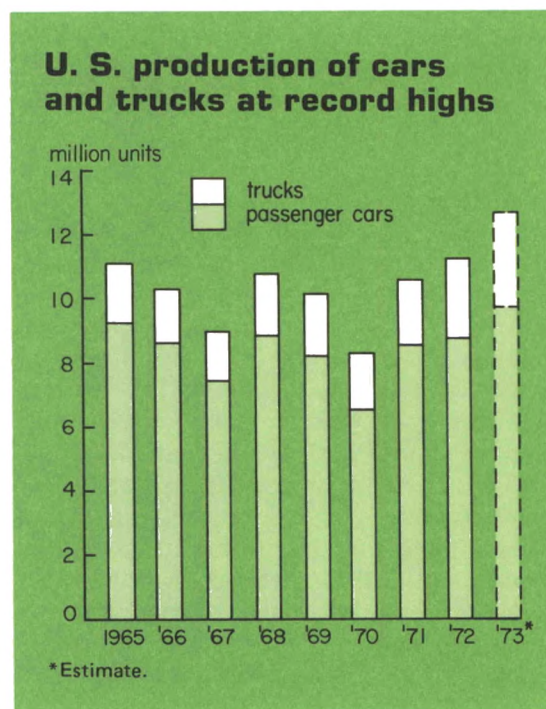
New car deliveries were up 19 percent from last year in the first four months. The largest gains were scored by various compacts and subcompacts. Some standard-sized cars lost market position in the first quarter, a trend that started with the rise of imports.

Despite all the publicity given to small cars, standard-sized Chevrolets and Fords

are still by far the largest sellers of any models in the U. S. market. But sales of Chevrolets and Fords have increased much less than total car sales this year. The proportion of the total passenger car market going to these two types was 14 percent in the first four months of 1973, compared to 16 percent in the same period last year. In past years, the share of the market taken by these cars has been much larger.

In the first four months of 1973, General Motors produced 55 percent of the autos assembled in the United States, Ford accounted for 26 percent, Chrysler 16 percent, and American Motors 3 percent. Allowing for fluctuations associated with strikes or popularity of various new models, these proportions have been fairly stable for the past decade.

The U. S. passenger car industry has consisted of only four firms since 1963, when Studebaker stopped production. The last Packards date from 1958 and the last Hudsons from 1955. Kaiser-Fraser cars were produced from 1946-54.



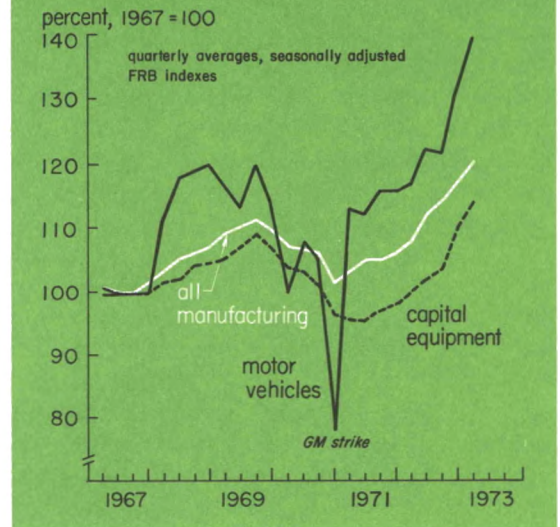
There are many more U. S. truck producers than car producers. Nevertheless, the Big Three also are dominant in trucks. In 1972, General Motors had 39 percent of the truck market (Chevrolet and GMC), Ford had 34 percent, and Chrysler (Dodge) 11 percent. International had 7 percent and a number of producers shared the remainder of the market. Most of these "independents" specialize in heavy-duty or special purpose trucks. These proportions have not changed substantially in recent years. (Off-highway trucks—very important in mining and earthmoving but relatively small in number—are not included in these data.)

Trucks accounted for 19 percent of all motor vehicles sold in the United States in 1972. Ten years earlier, truck sales were 13 percent of the total, a proportion that had not changed much for many years. From 1962 to 1972, car sales rose 54 percent, while truck sales rose 134 percent. Apparently, truck sales will increase faster than car sales again in 1973. Among the reasons for the surge in truck sales are the continued shift from rail to highway transportation, and the increased use of light trucks for personal transportation and recreation.

The number one industry

Producers of motor vehicles and parts currently employ more than 925,000 people, about 5 percent of all factory workers. Several hundred thousand additional workers are employed in operations that are not identified as automotive parts in official statistics, but supply the industry with raw materials and components, such as steel, body panels, and tires. In 1972, and, on average, since World War II, the motor vehicle industry has accounted for 8 percent of all goods produced in the United States, and for 20 percent of all durable goods. None of these data take into account the number of people employed in service stations and other businesses that keep motor vehicles operating.

Output of motor vehicles outpaces total manufacturing



The auto companies are among the best customers of many industries supplying metals and other materials. They use about 20 percent of all steel products, and more than 40 percent of all hot and cold rolled sheet. They use 8 percent of the copper, 10 percent of the aluminum, 11 percent of the nickel, one-third of the zinc, two-thirds of the rubber, and three-fourths of the plate glass consumed in all U. S. manufacturing activities.

From the early days of the industry, Michigan has been the leading producer of motor vehicles and parts, but its relative share of the industry's employment has declined from 55 percent in the early 1950s, to 43 percent in the 1960s, and to 41 percent in the 1970s. The erosion of Michigan's position may have stopped. The Big Three have indicated they will maintain and expand their operations in Detroit and other southern Michigan centers, which is their "home" area.

Industry expansion

Producers of motor vehicles and parts

plan to spend a record \$2.2 billion on new plant and equipment in the United States in 1973 according to a recent government survey. This would be an increase of 21 percent from the 1972 level, which, in turn, was up 19 percent from 1971.

Auto industry plant and equipment spending has followed three broad waves since World War II. The first wave reached its crest in the mid-1950s; the second in the mid-1960s; and the third seems to be gathering strength at the present time. The boom in machine tool orders in the past six months in part reflects heavy demands of the automotive firms. The amplitude of cycles in motor vehicle industry capital outlays has been very large. For example, from \$700 million in 1961, capital spending rose to \$1.9 billion in 1965, and then declined to a low of less than \$1.4 billion in 1968.

Pollution controls

In recent years, the auto companies have modified engines and exhaust systems of motor vehicles to reduce emissions. Although much has already been accomplished, the industry has a long way to go to meet the goals of the Environmental Protection Agency (EPA).

The problem of internal combustion engine pollution is very difficult, especially in gasoline engines, because increased combustion efficiency, which reduces emissions of carbon monoxide and unburned hydrocarbons, tends to increase emissions of oxides of nitrogen. The 1972 models get fewer miles per gallon than the 1971s and, apparently, the decline in fuel economy was even greater with 1973s. Motor vehicles use about one-half of the nation's supply of petroleum products, which are in increasingly short supply. Smaller vehicles, with less powerful engines, usually have lower levels of emissions and better fuel economy, but such cars do not meet the tastes of a large share of the public.

The major auto producers say they have been able to meet the 1975 EPA standards using specially built cars and trained drivers (although with a very sharp increase in fuel consumption), but this performance cannot be expected in mass-produced cars in the hands of the public. A major foreign producer also protested it would be unable to meet 1975 standards on schedule. Faced with the possibility of a drastic cutback in availability of new autos in the fall of 1974, the EPA announced in April a one-year extension of its 1975 standards. The industry maintains the interim regulations still present serious problems.

Motor vehicle producers also are modifying cars and trucks to meet safety standards. Impact-absorbing bumpers, new braking systems, and a variety of other features are in use or under development. Producers of trucks and truck engines also are working on devices and design changes to meet maximum noise level standards.

The urgent need to control pollution and improve safety is generally accepted. But, unless unforeseen breakthroughs occur, implementation of these programs can be expected to be costly in terms of increased prices of vehicles, higher maintenance costs, and larger fuel consumption.

Vehicles and people

In the spring of 1973, there were about 105 million cars and trucks in use in the United States, including vehicles owned by business and governments. The population currently is estimated at 210 million people, so there is one vehicle for every two people—including infants and people in institutions. The ratio of vehicles to people has increased steadily, from 1 to 5 in 1940; 1 to 4 in 1950; and 1 to 3 in 1960.

The 105 million vehicles include 85 million passenger cars and 20 million trucks and buses. With only 2.5 people per passenger car, the entire human population could

ride comfortably in the front seats of the nation's cars. In large cities during rush hours, it sometimes appears that they are doing just that! No other nation approaches the United States in the proportion of car ownership.

Data compiled by the Bureau of the Census show that, in mid-1972, 80 percent of the nation's households owned one or more cars; 30 percent two or more; 6 percent three or more; and 15 percent owned at least one truck. (A household consists of one or more persons occupying the same living quarters.) The proportion of households owning at least one car has remained at just under 80 percent since 1967. (It had been 75 percent in 1960.) The proportion of households owning two or more cars has increased every year since 1960 when it was 16 percent.

Because the proportion of households owning one or more cars has not changed since 1967, the expanding car market has reflected increases in the number of households and in multiple car ownership. The picture is confused somewhat by the spread of truck ownership. Farm families, self-employed persons, and others may use a truck as a first or second car.

Because independent transportation is highly prized, the absence of car ownership on the part of about one-fifth of the population is explained by inadequate income, infirmity, or residence in a congested area where a private car may be more trouble than it is worth.

Car ownership is somewhat more frequent in the Midwest and West than in the East and South. In all areas, car ownership is much more common among whites than blacks (83 percent versus 55 percent) and among suburbanites than residents of central cities (87 percent versus 66 percent). The most important determinant, however, is income.

At least 95 percent of households with incomes of \$10,000 or more, and with heads of households under 60 years of age,

own cars. Multiple car ownership is closely tied to income, but also to the number of drivers. More than 60 percent of the households with incomes of \$15,000 or more, and headed by a person 35 to 65 years of age, own two or more cars. These households are more likely to include young drivers and working wives.

Registrations and scrappage

The high level of auto sales in the past two years has not resulted in a significant acceleration in the rate of growth of cars in use. R. L. Polk Co. compiles data on vehicle registrations and estimates annual scrappage, and the number of cars in use. These figures show that growth in the number of cars in use has averaged 3.9 percent annually for the past 20 years. The rise in cars in use in 1971 and 1972 was near this average. Through most of the 1960s, the rate of growth of the car population was below the long-term average.

R. L. Polk estimates auto scrappage indirectly by "disappearance"—the number of cars previously in use that are not registered in a given year. To some extent, scrappage reflects the strength of new car sales, because a rise in the number of new cars tends to reduce the market value of older used cars to the point where they are not worth repairing. But over a period of years, scrappage is mainly a function of the age of the vehicle. For many years, the "half life" of passenger cars has been about ten years—i.e., only half of the cars of a given model year are still in use ten years later. (The number in use declines rapidly following the tenth year.) This half life of cars is not to be confused with the average age of cars in use at a given time, which is about 5.5 years.

In the past ten years, annual scrappage has averaged 9 percent of the number of cars in use at the start of the year. In 1971, more than 7 million cars were scrapped, and in 1972 scrappage may have ap-

proached 8 million. The latter figure would exceed car sales in any year prior to 1964. Scrappage has been equivalent to 70 percent of new car sales in each of the past four years. Therefore, only 30 percent of new car sales reflect additions to the stock.

Car and truck sales, historically, have fluctuated sharply from year to year, mainly as a result of strikes or business cycles. But the uptrend in vehicles in use has been almost continuous since motor vehicles became available in the early years of the century. Cars and trucks in use declined in only two periods: 1930-32 (the Great Depression), and 1942-45 (World War II). During the Depression, many people gave up ownership of cars or trucks, but only under greatest necessity. After the United States entered World War II, passenger cars were not produced at all, and trucks were produced only in limited numbers for essential civilian needs.

In the past five years, when the stock of cars increased by an average of 3.5 percent annually, the number of trucks increased 5.9 percent annually. This experience contrasts with the 1950s, when cars in use increased faster than trucks.

Trucks last about one-third longer than cars, on average. Construction is more rugged and maintenance is usually better. But trucks do wear out, and scrappage has been about 1 million annually in the past three years, about 6 percent of the trucks in use on January 1. Truck scrappage was only half as great as current sales in these years, compared with 70 percent for cars.

Expenditures on motor vehicles

In 1972, the Department of Commerce estimated that consumers spent \$49 billion on autos and parts, up 12 percent from 1971. This was more than 6.1 percent of total after-tax income, the highest proportion since 1955, and well above the average for the past decade. (Data on spending on cars and parts usually cited in-

clude outlays on mobile homes, which totaled \$4 billion in 1972, and was at substantially higher rates in early 1973.) In the first quarter of 1973, consumer purchases of autos and parts were at an annual rate of \$55 billion, up 20 percent from the year-earlier period, and a record 6.5 percent of after-tax income.

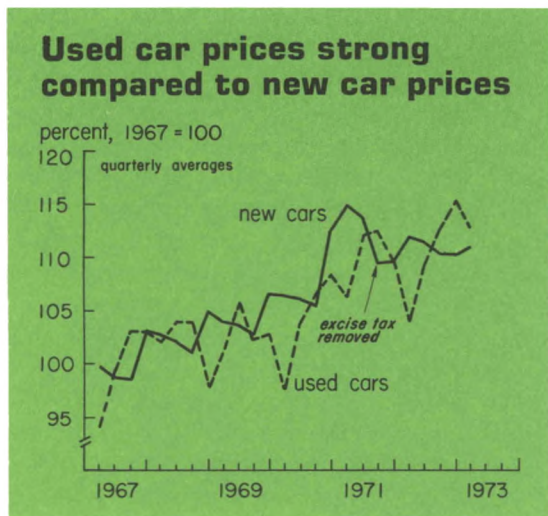
Autos and parts are the most important class of durable goods purchased by consumers, and the amount spent for them almost always exceeds the outlays on all types of furniture and household equipment combined. Moreover, the average purchase price of new cars, now about \$3,700, exceeds by a large multiple the average price of furniture, appliances, or TV sets. For the 15 percent, or so, of U. S. families that buy new cars in a given year, the purchase represents an investment that dwarfs almost all other outlays, except homes.

Consumers spent about \$41 billion on gas and oil, repairs, insurance, and other charges in 1972. The proportion of after-tax income spent on operating and maintaining autos has been a steady 5.1 percent in recent years. Total expenditures on cars and parts plus operation and maintenance average about 11 percent of after-tax income. Only food, about 17 percent, and housing, about 13 percent, take a larger share.

Trends in vehicle prices

According to National Income Accounts data, motor vehicle prices averaged slightly lower in 1972 than in 1971 (mainly because of the removal of the manufacturers' excise tax), after rising sharply in earlier years. Vehicle prices were 14 percent higher in 1972 than in 1966, compared to a rise of 28 percent for all goods and services. From 1960 to 1966, when the general price level rose 10 percent, vehicle prices *declined* 3.5 percent.

In the first quarter of 1973, according to the Consumer Price Index (CPI) of the Bureau of Labor Statistics (BLS), new car



prices were 1 percent below a year earlier, while all consumer prices were up 4 percent. Used car prices, however, were 9 percent higher than a year ago. The difference between new and used car price trends may, in part, reflect the fact that wholesale prices of new cars have been under effective control by the government.

Although official indexes show new car prices slightly lower than last year, the average purchase price of new cars has been about 6 percent higher. A major reason for the difference is that the BLS estimates the value of new features incorporated in new cars and deducts this amount from selling prices to permit comparison with prices in previous years. Changes introduced in 1973 models, including anti-pollution devices that cut gas mileage, were deemed to improve overall quality more than the increase in the selling price—regardless of what car buyers might think. Average purchase prices of cars can also rise from year to year because of shifts toward more expensive models.

Manufacturers publish suggested list prices for cars and optional equipment. These are the “sticker prices” attached to car windows before sale (as required by federal law since the late 1960s). The wholesale price paid by the dealer ranges

from 75 to 80 percent of the sticker price. Retail sales prices of particular cars are determined by market conditions and bargaining between the dealer and his customers. Usually the purchase price is the wholesale price plus \$100 to \$300 to cover salesmen’s commissions, overhead, and profits. This is the dealer’s gross margin, which has probably averaged somewhat larger in 1973 than in recent years because of the strength in demand and inadequate supplies of many types of cars. The difference between the actual selling price and the list price is covered by an “overallowance” on a trade-in or a discount in lieu of trade-in.

Instalment credit growth

About 70 percent of the new cars bought by consumers are purchased on instalment contracts according to available data. Actually, the proportion is probably even higher. Loans secured by real estate, and loans on life insurance policies, for example, may be used to purchase cars even though this purpose may not be known to the lender.

At the end of March, auto instalment credit outstanding totaled almost \$46 billion, up more than 17 percent from a year earlier. The proportion of auto credit to total instalment credit held by all lenders was 35 percent, the same as a year earlier. In the four-month period, December through March, however, autos accounted for 43 percent of the rise in total instalment credit.

Commercial banks now hold over 61 percent of all auto loans. This proportion, which has been rising gradually in recent years, was 56 percent in 1965. Finance companies now account for less than 23 percent of auto instalment paper, after declining from more than 32 percent in 1965. Most large finance companies that are not subsidiaries of auto manufacturers withdrew from the auto finance field in recent years because intense competition

reduced the profitability of this lending relative to other outlets for funds. "Other financial institutions," mainly credit unions, increased their share of auto installment credit from less than 11 percent in 1965 to about 15 percent currently. Auto dealers hold less than 1 percent of installment credit outstanding.

For many years, the typical new car loan has carried a 36-month maturity. The average maturity of auto loans made by major auto finance companies has held steady for at least two years at about 35 months. Reports appear from time to time of maturities of 42 months or more being offered by certain banks, but no clear trend beyond 36 months has developed.

The average loan on new cars by major auto finance companies is for almost 90 percent of the dealer cost, a proportion that has been very stable in recent years. Auto lending is based on the principle of maintaining a safe margin between the wholesale value of the car and the balance outstanding on the loan. Some lenders believe that such a margin cannot be assured on loans with maturities of 42 months or more. If lenders do start extending maturities beyond 36 months in significant volume, such loans probably will be confined to preferred risks.

Federal Reserve surveys of lenders indicate little change in interest charges on car loans since mid-1971. The average annual percentage rate charged by major auto finance companies on contracts purchased from dealers has been 12 percent on new car loans. Banks have charged 10 percent, on average, on direct loans to their customers. (About 60 percent of auto loans held by commercial banks are purchased paper and 40 percent are direct.) Rates charged on new auto loans are generally slightly lower than rates on loans to purchase other consumer goods.

Auto credit has been generally available since World War II. Even in times of tight credit conditions, there has been

little, if any, evidence that reduced availability of credit affected auto sales directly. Many banks and other institutions wish to increase their auto loan volume. In the spring of 1973, with some types of bank credit under allocation, major banks were actively soliciting new car loans. The large finance companies affiliated with auto producers exist for the purpose of aiding car sales. Their borrowing power in the money and capital markets is enormous.

Upcoming labor negotiations

Ever since the CIO organized the auto and steel industries in the 1930s, labor contracts negotiated by the United Auto Workers (UAW) and the United Steel Workers (USW) have foreshadowed developments in labor negotiations later adapted in other sectors. Wages have increased steadily—average hourly earnings of the auto and steelworkers are about 35 percent above the average for all manufacturing. These unions also have pioneered cost-of-living adjustments and a series of nonwage benefits, including pensions, paid vacations, additional paid holidays, supplementary unemployment compensation, and company-paid medical insurance. Most of these benefits have been liberalized periodically through the years.

Since 1959, the auto and steel industries have negotiated three-year contracts. Auto industry bargaining has preceded steel industry bargaining by about one year. The auto contract will expire in September 1973; the steel contract in August 1974.

Although the UAW and the USW are both industry-wide unions, there are significant differences in their modes of operation. The major steel firms bargain with the union as a unit, but the auto companies bargain independently. Another difference is that, since 1959, the steelworkers have concluded negotiations without a strike on economic issues. (But there have been disruptive strike-hedge inventory buildups be-

fore each contract deadline.) The auto industry, on the other hand, was hit by major strikes in 1964 and 1967, when production of almost 500,000 vehicles were lost in each calendar year, and in 1970, when strikes cut output by about 1.5 million units. Much of this "lost" production was made up in the following year, but the immediate impact on company profits and worker income was severe.

The UAW has already made known that in 1973 it will demand a substantial wage increase, voluntary retirement after 30 years' service regardless of age ("30 and out"), dental care assistance, and voluntary overtime. Industry leaders point to the higher cost of early retirements (pensions are paid for a longer period of years), and maintain that voluntary overtime will greatly hamper efficiency of operations and raise costs of production.

As the strike deadline of mid-September approaches, interest will center on the question of which company the UAW will choose as its strike target. In 1967, it was Ford; in 1970, General Motors. Both sides have a strong incentive to avoid a strike in a year of high employment and excellent profits. Both sides probably will bargain with handicaps. The union's strike fund is said to be relatively low, still reflecting the erosion suffered during the long strike in 1970. On the other side, the auto companies are expected to enter September with relatively low inventories of finished cars and trucks. Large inventories in dealers' hands provide a cushion against losses in output.

Looking ahead

The top months for motor vehicle sales, especially passenger cars, are April, May, and June, when the open road beckons, and October and November, following the introduction of new models.

Nevertheless, the variation from year to year is sufficiently great that "seasonally adjusted annual rates" should be used with caution. On a quarterly basis, the picture is less clouded, although variable nonetheless.

In the past five years, adjusting for the 1970 strikes, the first and third quarters each have accounted for 23 percent of the year's auto sales, on average, while the second and fourth quarters each have accounted for 27 percent. If this pattern holds in 1973, passenger car sales would reach the fantastic total of 12.8 million (including 2 million imports), and truck sales would be well over 3 million! These totals are believed to be beyond the productive capacity of U. S. industry. Moreover, sales of cars, especially imports, are believed to have been stimulated in the first quarter by expectations of price increases. Aside from capacity restraints, recent sales of domestic-type cars and trucks appear to be at unsustainable rates by relevant historical comparisons, and particularly so if the present rapid rate of economic growth slows in the second half of the year.

In the broader view, the increase in cars in use in the past two years has not been above long-term patterns, especially when the more rapid rise in income and the faster growth in household formation are taken into account. The uptrend in sales of trucks for personal use and for freight transport is virtually certain to continue. The rise in the motor vehicle population is a worldwide phenomenon. With growing incomes, other nations are following the pattern long established in the United States. Despite rising costs, pollution, and traffic congestion, the utility, flexibility, and prestige offered by motor transport can be expected to provide expanding markets for cars and trucks.

George W. Cloos

Banking developments

New seasonal borrowing privilege

An amendment to Federal Reserve Regulation A, providing for a formal "seasonal borrowing privilege" to qualifying member banks, became effective April 19. Under this amendment, a member bank that experiences recurring heavy loan demand or deposit outflow, or both, about the same time each year can prearrange to borrow from its Federal Reserve bank to accommodate most such demands. It is expected that the availability of seasonal credit will enable many smaller banks to better serve their communities by allowing them to be more responsive to the overall credit needs of local borrowers.

Eligibility for the seasonal borrowing privilege is based on the following criteria.

- The bank must lack reasonably reliable access to national money markets.
- The seasonal need must arise from recurring movements in a bank's deposits and loans.
- The seasonal need must persist for at least eight consecutive weeks.
- The seasonal need must exceed 5 percent of the bank's average total deposits in the preceding year.

Banks precluded because of size or location from acquiring funds in national money markets are often located in communities dominated by one or more seasonal industries such as agricul-

ture or tourism. These banks may experience relatively large deposit inflows and light credit demands during one season and relatively large deposit outflows and heavy credit demands during another. Without an external source of funds, banks with such seasonality may not be in a position to make loans to some credit-worthy customers during seasons of deposit inflows in anticipation of a shortage of funds in the coming season. During seasons of deposit

Potential borrowing under seasonal borrowing privilege

(Amounts in million dollars; number of banks in parentheses)

	Illinois	Indiana	Iowa	Michigan	Wisconsin	Total
January	16.1 (39)	2.3 (6)	1.3 (10)	3.3 (6)	1.6 (7)	24.4 (68)
February	22.9 (51)	11.8 (10)	13.0 (17)	1.6 (6)	4.8 (7)	54.1 (91)
March	17.1 (55)	6.7 (11)	15.4 (19)	1.8 (5)	5.2 (8)	46.2 (98)
April	14.7 (51)	3.8 (12)	2.1 (21)	3.9 (5)	3.6 (10)	28.1 (99)
May	16.5 (52)	3.2 (12)	5.4 (32)	8.9 (14)	6.5 (16)	40.5 (126)
June	18.2 (42)	1.9 (10)	20.8 (33)	10.4 (14)	6.3 (13)	57.7 (112)
July	7.4 (30)	1.8 (10)	7.3 (28)	12.7 (14)	12.5 (11)	41.6 (93)
August	23.6 (41)	1.7 (10)	38.2 (24)	7.9 (11)	11.0 (9)	82.4 (95)
September	18.9 (45)	2.2 (14)	29.7 (23)	3.9 (9)	5.5 (7)	60.1 (98)
October	19.8 (31)	4.5 (12)	3.7 (15)	6.6 (6)	3.6 (9)	38.4 (73)
November	23.0 (32)	2.2 (8)	10.8 (15)	11.3 (6)	7.4 (12)	54.7 (73)
December	17.4 (35)	1.1 (5)	17.4 (14)	15.1 (5)	8.0 (12)	59.1 (71)

*Preliminary estimate of average amount and number of banks for Seventh Federal Reserve District based on deposit and loan data available to the Federal Reserve System covering the years 1968 through 1972.

outflows and heavy credit demands, banks are constrained in making additional loans unless some outside funds are available.

Federal Reserve banks have granted seasonal credit in the past but not on a formal and predetermined basis, as with the seasonal borrowing privilege. Since specific quantities and durations of borrowing under the privilege must be arranged between individual bankers and discount officials, bankers eligible for the seasonal borrowing privilege have better knowledge of the extent they can expand their portfolios during periods of deposit inflows and can count on credit from the Federal Reserve during periods of deposit outflows to maintain their built-up loan portfolios.

Analysis of loan and deposit patterns of all member banks indicates that, in general, qualifying banks will have under \$100 million in deposits and the majority will have under \$50 million. The seasonal borrowing privilege may be available to larger banks if alternative means of making adjustments are not readily available.

Preliminary calculations indicate that as many as 300 Seventh District banks may qualify for the seasonal borrowing privilege. If all these banks were to arrange to borrow the full amount for which they appear to qualify, seasonal borrowing would peak in this district at a little over \$80 million in the month of August. However, May and June appear to be the months in which the greatest number of Seventh District banks will be likely to be borrowing under the new privilege. (See table on previous page.)

Bank profits remain stable

Profits showed little change between 1971 and 1972 at the average member bank according to the most recent tabulation of Seventh District operating ratios. Profitability—income after taxes and before securities gains or losses as a percent of equity capital including all reserves—

increased only 3 basis points over 1971 to 9.93 percent and was over 60 basis points below the 1969-70 average. Gains on sales of securities contributed 59 basis points to the overall rate of return on equity in 1972, about one-third less than in 1971.

Among deposit-size groups, profitability of the average bank ranged from 8.04 percent for the smallest banks (under \$5 million deposits) to 10.74 percent for banks in the \$50 to \$100 million group. Relative to 1971, three deposit-size groups showed declines and four showed increases in profitability. For the group with the largest decline (\$10 to \$25 million deposits), interest on deposits rose much more than loan revenue. The biggest banks (over \$500 million deposits) had the largest profitability gain. For them, the increase in loan income was smaller, but they showed almost no rise in interest expense over the previous year.

Operating Ratios 1972, relating member bank income data to balance sheet data, is available on request to Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago, Illinois 60690.

Financing loan growth

Large banks in major cities relied heavily on money market sources to finance the record loan expansion in the first quarter of 1973. Loans at weekly reporting banks showed a nationwide rise of \$15 billion, of which more than \$9 billion were to commercial and industrial businesses. In addition, a decline in demand deposits—normal in the early months of the year—absorbed almost \$6 billion.

To offset these drains, the inflow of time and savings deposits, other than large negotiable certificates of deposit, supplied less than \$3 billion. Another \$3.6 billion was acquired through net sales or redemptions of investment securities. Most of the funds needed, however, were obtained through the net increase of \$9.6 billion in

Uses and sources, first-quarter 1973, large banks in major cities

	Chicago	Detroit	Indianapolis	Milwaukee	Des Moines	New York	Other U. S. cities	U. S. total
	<i>(million dollars)</i>							
Uses								
Loan expansion:								
Commercial & industrial	1,126	80	97	56	19	3,284	4,510	9,190
Other	944	157	10	62	22	915	3,973	6,065
Decline in demand deposits	176	173	6	44	19	2,110	3,335	5,863
Other, net	—	180	—	17	—	408	—	—
Sources								
Reduction in security holdings	319	199	72	66	5	1,960	948	3,568
Increase in:								
CDs over \$100,000	899	111	94	125		4,207	4,123	9,557
Other time & savings deposits	272	157	31	2	6	78	2,339	2,875
Nondeposit sources	577	90	-149	-15	54	391	3,504	4,452
Capital accounts	11	33	21	1	1	81	433	581
Other, net	169	—	44	—	6	—	471	85

Note: Based on averages of data for Wednesdays in December 1972 and March 1973. Loans include those sold to affiliates; demand deposits are net of cash items; nondeposit sources include net purchases of federal funds and securities sold under repurchase agreements, borrowing from Federal Reserve banks and others, and other liabilities and loans sold to affiliates.

outstanding CDs in denominations over \$100,000. Bank CDs compete with other money market instruments such as U. S. Treasury and Agency securities and promissory notes of corporations (commercial paper) for short-term investment funds. Aggressive bidding for these funds drove offered rates on CDs up by 150 basis points or more during the quarter, and before the end of March legal ceilings effectively prevented banks from selling CDs maturing in 90 days or more. Ceilings on 30- to 89-day CDs have been suspended since mid-1970. Nondeposit sources provided another \$4.5 billion to these banks in the first quarter, including increases of \$800 million in borrowings from the Federal Reserve banks, \$1.7 billion in net federal funds purchases (interbank loans), and \$500 million in loans sold to affiliates.

Source-use patterns were similar in New York and Chicago, but differed in other district cities. (See table.) At large Detroit banks, where loan expansion was

slower (less than 4 percent, compared with 13 percent in Chicago), there was less need to tap the CD market. A relatively large proportion of the overall growth in non-CD time deposits and nondeposit liabilities was accounted for by banks in other cities.

Information on assets and liabilities of smaller banks is not available in the same detail. Gross loans of "country" member banks in the first quarter rose 4.3 percent in this district and 3.4 percent nationally. While these gains, too, are unusually large, time deposit inflows were sufficient to finance them and to support a net increase in investment securities. Part of the loan growth at the smaller banks, moreover, was in the form of increased sales of federal funds to the large banks, indirectly helping the large banks finance their loan expansion. At country banks in this district, increased federal funds sales accounted for about one-third of the \$940 million rise in loans. The net inflow of time and savings deposits supplied more than \$1 billion.

